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SUBJECT: VIETNAM CIVAIR: SCENESETTER FOR OCT 6-8 OPEN SKIES TALKS

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REF:

- (A) HANOI 2678: "U.S. AND VIETNAM INITIAL AIR AGREEMENT";
- (B) HANOI 0029: "VIETNAM AIRLINES WILL EQUITISE";
- (C) HANOI 1974: "BOEING INKS AGREEMENT WITH VIETNAM AIR";
- (D) HANOI 0814: "SAFETY ISSUES COULD RESULT IN BLACKLIST"

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¶1. (SBU) Summary and Comment: Vietnam's civil aviation negotiator for upcoming negotiations with the U.S. stated that he is willing to discuss Open Skies, but noted that fifth freedom passenger services between Japan and Vietnam continue to be a concern. All-cargo liberalization is less problematic. As part of its ambitious expansion plans, Vietnam Airlines (VNA) wants to begin direct service to the U.S. It is also considering joining a major airline alliance and an American airline member of that alliance has told VNA that agreement to Open Skies is a prerequisite. At the same time, safety problems will delay any U.S. direct service and VNA is concerned about competition from U.S. carriers and the lack of fifth freedom rights from Japan for flights to the U.S.

¶2. (SBU) Comment: Vietnam's willingness to talk about Open Skies is positive, as is the apparently more open attitude toward cargo services. A key consideration for Vietnam and VNA in the upcoming talks will be balancing the benefits of joining a major passenger services alliance with the greater competition that Open Skies would bring. End summary and comment.

¶3. (SBU) The Embassy welcomes a civil aviation delegation to Hanoi from October 6-8, 2008 to conduct bilateral Open Skies talks with the Government of Vietnam (GVN). In 2003, the United States and the GVN entered into a five-year Air Transport Agreement that, while maintaining restrictions, contains many Open Skies provisions. The main impediment to full liberalization in 2003 was disagreement over fifth freedom passenger rights over Japan (REF A).

GVN WILLING TO NEGOTIATE; JAPAN 5ths A PROBLEM  
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¶4. (SBU) During a September 12, 2008 meeting with the Embassy, the Civil Aviation Administration of Vietnam's (CAAV) Deputy Director General, Lai Xuan Thanh, said that Vietnam is willing to discuss Open Skies (Thanh will head Vietnam's delegation at the upcoming talks). However, an exchange of fifth freedom rights for passenger services, particularly related to Japan, "remains difficult." Thanh stated that an agreement to liberalize all-cargo services could bring benefits to Vietnam's export-led economy since Vietnam does not have a competitor to the major U.S. express cargo carriers.

¶15. (SBU) Thanh said flag-carrier VNA is interested in expanding its network of codeshare agreements, including with U.S. carriers (VNA currently has a codeshare agreement with just one U.S. carrier, American Airlines). He noted that VNA was considering joining the Sky Team airline alliance, and had been told by alliance member Northwest Airlines that Vietnam needs an Open Skies agreement with the U.S. as a prerequisite. Thanh cautioned that CAAV's concern about Japan passenger routes would remain despite VNA's final position on Open Skies. CAAV had to consider the possibility that another Vietnamese carrier might want to operate Vietnam-Japan services in the future and might not be able to compete if the route was fully opened for U.S. airlines.

#### VIETNAM AIRLINES HAS AMBITIOUS PLANS BUT FIFTHS A PROBLEM

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¶16. (SBU) The Embassy also met with VNA's Trinh Ngoc Thanh, Director of Marketing and Planning and the carrier's representative at the upcoming talks. He said that VNA planned to begin flights five times per week from Ho Chi Minh City (HCMC) to Los Angeles (LAX) "in mid-2010." He stated that Vietnam has no fifth freedom agreement with Japan and that VNA has just 11 landing slots at Narita Airport. He noted this in contrast with Northwest Airlines, which has 360 slots. Without the right to pick up Japan passengers, the HCMC-LAX route would likely be unprofitable. Thanh, however, said VNA would adopt a "long-term vision" over short-term profit on the route.

¶17. (SBU) Thanh said the current bilateral agreement with South Korea gives VNA just three landing slots per week at Seoul's Incheon Airport. He also confirmed that VNA was considering joining the Sky Team Alliance and made the same point that VNA was being told that agreeing to Open Skies was a condition. He noted that while VNA is committed to opening up routes, the airline is worried about

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competition with other Asian and U.S. carriers between Vietnam and Japan.

#### CIVIL AVIATION: HIGHS AND LOWS

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¶18. (U) The upcoming civil aviation talks occur against the backdrop of a rapidly growing Vietnamese commercial aviation sector. VNA, which plans to "equitize" by selling a 20 percent stake in 2009 (REF B), has ambitions to become one of the preeminent air carriers in Southeast Asia. It has a fleet of 49 aircraft, and anticipating increased tourist and business traffic to Vietnam, plans to expand its fleet to 104 aircraft by 2015 and 150 by 2020. VNA carried a record 4.43 million passengers in the first half of 2008, up 15 percent from the previous year, with revenues up 28 percent to \$733 million. Due to high fuel prices and government-set price controls, however, VNA announced a net loss of \$5 million for the period.

¶19. (SBU) After a slew of high-profile corruption allegations at VNA over the last decade, including questionable aircraft and engine purchases, newly appointed CEO Pham Ngoc Minh seems to have induced a measure of accountability at the airline. Minh is spearheading modernization at the carrier, including the upgraded fleet, the recent purchase of a multimillion-dollar reservations system from U.S.-based Sabre Airline Solutions, and new and expanded routes.

#### CAUTIOUS EXPANSION IN PRIVATE AIRLINE SECTOR

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¶10. (U) The GVN is attempting to spur, albeit cautiously, expansion in Vietnam's nascent private airline industry. It has abolished the former 15 percent import tax on jet fuel and allowed three new airline applications through 2010.

¶11. (U) The combination of high fuel prices and domestic fare caps, however, has slowed what looked to be an ambitious year of expansion in the private air sector. Vietnam's sole budget carrier, JetStar Pacific, was formed in 2007 when Australia's national flag-carrier, Qantas, purchased an 18 percent stake in Vietnamese state-owned budget carrier Pacific Airlines. Qantas plans to increase its

ownership to 30 percent by 2010. Owing to high fuel prices, JetStar recently slashed its domestic service by 30 percent and postponed plans to increase the size of its fleet from five to 14 aircraft by the end of 2008. Despite the domestic route cuts, JetStar plans to launch regional service to Bangkok, Siem Reap and Singapore in late 2008.

¶12. (U) Vietnam's first two privately owned carriers, VietJet Air and Air Speed Up had been scheduled to begin service in late 2008. VietJet, however, recently fired its newly hired CEO and other executives, and shelved plans to begin flights and postponed leasing its first aircraft. Air Speed Up is still planning to initiate service in late 2008, although the company is attempting to change its name. In addition, a third startup, Mekong Air, recently filed an application to begin domestic service.

#### U.S. CARRIERS

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¶13. (SBU) United Airlines, which operates daily flights to HCMC via Hong Kong, is currently the only U.S. carrier to offer direct service from the United States to Vietnam using its own equipment. Cargo operators UPS and Federal Express each have operations in Vietnam, although only FedEx flies its own aircraft (once daily) into HCMC. Both companies are restricted by the inability to conduct fifth freedom and all-cargo seventh operations. FedEx's Vietnam representative told the Embassy that while the company has workarounds to meet its needs in Vietnam, it would prefer to have seventh cargo freedoms.

#### REGULATOR FAILS TO KEEP PACE

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¶14. (SBU) Although Vietnam Airlines has enjoyed an accident-free safety record over the last decade, Vietnam's civil aviation regulator, the CAAV, has failed to keep pace with the country's rapidly expanding commercial air traffic. A December 2007 audit by the International Civil Aviation Organization (ICAO) found serious shortcomings with Vietnam's aviation safety system (REF D). According to the ICAO report, the CAAV has insufficient resources to hire and retain qualified inspectors and experienced aviation safety technical staff and has no fulltime inspectors. The report also said that Vietnam's national civil aviation law does not empower the

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CAAV to regulate and oversee aviation safety, including inspections of aircraft and aviation facilities.

¶15. (U) The CAAV hopes to correct many of the problems through its work on a \$1.4 million technical assistance project funded principally by the U.S. Trade and Development Agency (TDA). The project, scheduled to wrap up in mid-2010, will help the CAAV upgrade its aviation safety oversight role and may help Vietnam secure an FAA Category I safety rating, allowing VNA to open service on its long-planned HCMC-LAX route.

#### AVIATION INFRASTRUCTURE

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¶16. (U) Rapid growth has imposed strains on Vietnam's outmoded system of transportation infrastructure and the GVN is racing to upgrade its aviation facilities. Vietnam will spend \$850 million to build a second terminal at Hanoi's Noi Bai International Airport, increasing capacity from six million to sixteen million passengers per year. The GVN will also build a second international airport in southern Vietnam to supplant Ho Chi Minh City's congested Ton Son Nhat International Airport. The new facility, Long Thanh International Airport, will be located approximately 40 kilometers northeast of HCMC and will serve 50-80 million passengers per year when it opens after 2012.

#### COMMENT: DECISION MAKING AND ECONOMIC OUTLOOK

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¶17. (SBU) The GVN retains a top-down decision-making process, despite independence at the mid and lower levels of the bureaucracy.

In cases where the bureaucracy takes the lead, Vietnam relies on a consensus decision-making process, which often results in a slow and cautious approach to commercial decisions and policy issues.

¶18. (SBU) The United States is currently Vietnam's largest export market and third largest overall trade partner. Two-way trade in goods with the United States in 2007 was \$12.53 billion, up 29 percent from 2006. While the great majority of experts consider Vietnam's long-term economic prospects to be bright, short-term macroeconomic imbalances are worrying investors. Vietnam's current turmoil is rooted in high inflation (28 percent year-on-year in October), a large current account deficit, and inefficient allocation of resources, which is particularly obvious in the disproportionate amount of state resources devoted to powerful State Owned Enterprises (SOEs).

MICHALAK